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IN THE

Supreme Court of the United States

OCTOBER TERM, 1957

No. 602

CITIES SERVICE COMPANY,
Petitioner,

—*against*—

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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November 8, 1957.

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IN THE

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OCTOBER TERM, 1957

CITIES SERVICE COMPANY, *Petitioner,* —*against*— SECURITIES AND EXCHANGE COMMISSION, *Respondent.*	No.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Cities Service Company prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit entered in this case August 14, 1957.

Opinion Below

The opinion of the Court of Appeals is reported at 247 F. 2d 646 and is printed in the Appendix at 3a-18a.

Jurisdiction

The judgment of the Court of Appeals was entered August 14, 1957 (App. 1a–2a; R. 132). The jurisdiction of this Court is invoked under Section 24 of the Public Utility Holding Company Act of 1935, 15 U. S. C. 79x(a)* and under 28 U. S. C. 1254(1).

*References herein to the Public Utility Holding Company Act of 1935 will be to original section numbers only.

Question Presented

Where, pursuant to orders of the Securities and Exchange Commission (Commission), entered under the Public Utility Holding Company Act of 1935,

A. Cities Service Company (Cities) and its subsidiaries have disposed of all domestic public utility holdings, and

B. Arkansas Fuel Oil Corporation (Fuel Oil), a Cities subsidiary, was reorganized to dispose of its utility interests, simplify its corporate structure and redistribute its voting power, as required by Section 11 of the Act,

do business relations (unchanged since the reorganization) between Fuel Oil and another oil company subsidiary of Cities make the existence of a publicly-held minority interest in Fuel Oil a violation of Section 11(b)(2) of the Act so as to permit the Commission to deny Cities an exemption from regulation under the Act until that minority interest in Fuel Oil is eliminated?

Statute Involved

The relevant sections of the Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U. S. C. § 79 *et seq.*, are Sections 2(a), 3(a) and 11(b), pertinent portions of which are set forth at Appendix 71a–72a.

STATEMENT

The judgment of which review is sought affirmed an order (Order) of the Commission, made August 31, 1956. The Commission had denied Cities exemption from further regulation under the Public Utility Holding Company Act

of 1935, 49 Stat. 803, 15 U. S. C. 79-79z (Act) and had indicated that Cities would have to eliminate a publicly-held minority interest in Fuel Oil, an oil company subsidiary of Cities.

Review of the Commission order was initiated by a petition filed by Cities pursuant to Section 24(a) of the Act.

A. Background of the Order

In 1935, Cities, although engaged primarily in the oil business, controlled substantial public utility interests. Accordingly, Cities was a "holding company" as defined in the Act (Section 2(a)(7)(A)) and was required to register with the Commission (Section 5(a)).

Thereafter, following various proceedings held before the Commission, Cities disposed of all its domestic public utility interests, in order that it might retain intact its oil subsidiary interests. *Cities Service Company*, 17 S. E. C. 5 (1944).*

At the time Cities registered under the Act, one of its subsidiaries was Arkansas Natural Gas Corporation (Arknat). The principal assets of Arknat were all the voting securities of two subsidiaries, Arkansas Louisiana Gas Company (Arkla), a gas utility company, and Arkansas Fuel Oil Company (Arkco), a non-utility oil company. Because of its ownership of the stock of Arkla, Arknat was a "holding company" under the Act (Section 2(a)(7)(A)), and it registered with the Commission as such. A majority of the stock of Arknat was owned by Cities and the remaining stock was publicly-held.

In October 1952, the Commission approved a plan (Plan) to bring Arknat into compliance with Section

*In compliance with Commission orders, Cities has disposed of securities or assets valued at approximately $184,500,000.

11(b)(2) of the Act by eliminating Arknat as a sub-holding company, simplifying its capital structure and correcting allegedly unfair distribution of its voting power and, also, to dispose of Arkla, the gas utility company (thereby effectuating compliance by Arknat with the 1944 Commission order under Section 11(b)(1) [17 S. E. C. 5]). The Plan provided for

(i) the distribution of the stock of Arkla, the gas utility, to the stockholders of Arknat;

(ii) the merger of Arkco, the oil subsidiary, into Arknat, with change of the Arknat name to Fuel Oil; and

(iii) the retirement of Arknat's preferred stock and reclassification of its two classes of common stock (voting and non-voting) into a single class of Fuel Oil voting common stock and distribution thereof in exchange for Arknat's outstanding shares. (App. 67a–70a; R. 45a–48a)

Because of its ownership of Arknat stock, Cities received 51.5% of the new common stock of Fuel Oil (which it retained) and a like percentage of the stock of Arkla, the gas utility subsidiary, which, in compliance with the 1944 Commission order, Cities sold.

At the hearings on the Plan, a committee representing certain stockholders of Arknat objected that the Plan did not accord a large enough distribution of Fuel Oil stock to the public holders of Arknat stock, or, as the Commission stated in its Findings and Opinion approving the Plan, to the failure of the Plan to make provision for eliminating the minority public interest. The attention of the Commission was directed to a so-called "hypothetical refinery" contract between Fuel Oil and another subsidiary of Cities.

That contract was part of a long-standing arrangement (since 1945) under which the other subsidiary refined crude oil, sold and delivered to it by Fuel Oil, and sold to Fuel Oil refined petroleum products. Although it was contended that numerous intercorporate claims existed, no such claims were found to have arisen under the aforesaid arrangement or any other continuing intercompany business dealings or relationships. The Commission did not hold that the Committee's objection affected the merits of the Plan as an appropriate means of effecuating compliance with the provisions of Section 11(b)(2) of the Act. Instead, in its Findings and Opinion approving the Plan the Commission stated:

> "We recognize that the continued existence of a minority interest in Fuel Oil presents a problem which may require corrective action. However, in view of the fact that Fuel Oil will remain under our jurisdiction as long as Cities is a registered holding company (a status which will continue until terminated by us), we believe that consideration of the problem may be deferred until a later date." (App. 58a–59a; R. 37a)

And in its order approving the Plan, the Commission reserved jurisdiction over:

> "The resolution of the problems presented by the continued existence of a minority public interest in Fuel Oil after the consummation of the plan." (App. 68a; R. 46a)

There was no suggestion, however, that the existence of the minority might not be sanctioned by Section 11(b)(2). Such a question would have gone to the very essence of the issue then before the Commission, *i.e.*, whether the Plan would effectuate the result required by Section 11(b)(2). Indeed, the minority interest in Fuel Oil was

created by the Plan which also provided for an elaborate and costly distribution of the new stock of Fuel Oil to approximately 20,000 public shareholders.*

On January 29, 1955, Cities filed an application under Section 3(a)(5) of the Act, seeking exemption from provisions of the Act (R. 1B, Doc. 1). The Commission consolidated the exemption proceeding with the earlier proceeding on the 1952 Plan (R. 1B, Doc. 2).

Following hearings, the Commission entered, on August 31, 1956, its Findings and Opinion and the Order denying exemption (App. 19a–46a, 47a; R. 1a–26a, 27a). The Findings and Opinion focus upon the "hypothetical refinery" contract. The Commission did not hold, however, that the contract was unfair. It did conclude, though, that any business dealings between Fuel Oil and another subsidiary of Cities raise an "inherent conflict of interest" between Cities and the public minority interest in Fuel Oil which results in an "inequitable distribution of voting power", prohibited by Section 11(b)(2).** The Commission also concluded:

> ". . . that this condition can be satisfactorily rectified only by eliminating the minority public interest in Fuel Oil or by Cities disposing of its interest in Fuel Oil." (App. 46a; R. 26a)

*The stockholders committee which had objected to the failure of the Plan to provide for elimination of the minority interest disbanded following consummation of the Plan and has never again appeared in these proceedings.

In 1953, Fuel Oil, in a proceeding to which Cities was not a party, applied to the Commission under Section 5(d) of the Act for an order terminating its status as a registered holding company. The Commission granted the application, subject to a reservation of jurisdiction over Fuel Oil as a "registered holding company" in respect of the matters over which jurisdiction was reserved in the order approving the Plan (R. 23B, Doc. 26).

**The Commission has expressly held that its

> ". . . need for taking action with respect to the public minority interest is not contingent upon a finding of spoliation or abuse." (App. 44a; R. 24a)

B. The Judgment Below

On petition for review, the Court of Appeals affirmed the Order of the Commission. It held that if a majority has concern for interests outside the company

> ". . . which *may be* adverse, there is no common interest and the minority is effectively disenfranchised--its votes are meaningless and it is at the mercy of the majority." (App. 16a; R. 128) [Emphasis added.]

Calling that possible abuse of the Fuel Oil minority an "inequitable distribution of voting power", the Court of Appeals concluded that existence of the minority interest in Fuel Oil is proscribed by Section 11(b)(2). In other words, there can be no such thing as a fair and equitable distribution of voting power among security holders if there are intra-system business dealings.

C. Elimination of the Fuel Oil Minority Has Been Ordered

On September 20, 1957, the Commission entered an order, based upon the record and proceedings in this case, requiring Cities and Fuel Oil,

> ". . . to proceed with due diligence to take appropriate action to effect the elimination of the public minority stock interest in Arkansas Fuel Oil Corporation or the disposition by Cities Service Company of its stock interest in Arkansas Fuel Oil Corporation". (H. C. A. Rel. No. 13549)

On November 8, 1957, Cities filed a petition for review of that order in the United States Court of Appeals for the Third Circuit.

REASONS FOR GRANTING THE WRIT

The decision below holds that business relations between a subsidiary and its parent (or subsidiaries thereof) make it impossible to have a distribution of voting power among security holders of such subsidiary that would not be unfair or inequitable. In such a case, *any distribution* of voting power *among* security holders in the subsidiary would be inherently inequitable. That decision will have far-reaching and drastic effects. It is in conflict with express provisions of Section 11(b)(2) of the Act. It is in conflict with decisions of this Court. It conflicts with principles, long recognized by the Congress, governing intercorporate transactions.

A. The decisions of the Commission and the Court of Appeals disregard [1] unequivocal jurisdictional limitations contained in Section 11(b)(2), [2] prior determinations of the Commission and the courts in this proceeding, and [3] a line of Commission precedents going back to inception of regulation under the Act.

1. Jurisdictional Limitations of Section 11(b)(2).

In its Opinion, the Commission held that:

> ". . . the existence of the public minority interest in Fuel Oil constitutes a complexity and results in an inequitable distribution of voting power within the meaning of Section 11(b)(2) of the Act . . . [and] . . . this condition can be satisfactorily rectified only by eliminating the public minority interest in Fuel Oil or by Cities disposing of its interest in Fuel Oil. . . ." (App. 46a; R. 26a)

The Court of Appeals, passing basic problems raised by this case, affirmed.

The validity of that decision depends upon the scope of Commission power under Section 11(b)(2) of the Act.

(a) The first sentence of Section 11(b)(2) requires the Commission

> ". . . to ensure that [1] the corporate structure or [2] continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure or unfairly or inequitably distribute voting power among security holders of such holding-company system."

Since neither the Commission nor the Court of Appeals held that the "continued existence" of Fuel Oil results in "an inequitable distribution of voting power" within the meaning of Section 11(b)(2), the only power remaining to the Commission under the first sentence of that Section is to *ensure that the corporate structure* of Fuel Oil

> ". . . does not [1] unduly or unnecessarily complicate the structure, or [2] unfairly or inequitably distribute voting power among security holders"

of the Cities system.

By refusing to acknowledge this limitation, the Commission and the Court of Appeals grievously err. In disregard of Section 11(b)(2), they urge that the Commission shall regulate every circumstance that may have any effect on voting power, whether or not it complicates structure or changes the distribution of voting power. Indeed, as the Court of Appeals put it, Section 11(b)(2)

> ". . . is concerned with an undesirable effect, regardless of its cause." (App. 15a; R. 128)

But the Act by its very terms limits Commission inquiry to effects produced by only two causes. Both Section 11(b)(2) and its legislative history make patent that the

Commission may act if, (and *only* if) it is the [1] corporate structure or [2] continued existence of a company that complicates system structure or inequitably distributes system voting power.

To read Section 11(b)(2) as do the Commission and the Court of Appeals makes meaningless all reference in that Section to either "corporate structure" or "continued existence".

If the position of the Commission and the Court of Appeals is correct, then Section 11(b)(2) has been judicially amended to read:

> (2) to require by order, . . . that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that *anything regardless of its cause, relating to* any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among the security holders, of such holding-company system.

Clearly, if Congress had intended Commission power to be as broad as the Commission and the Court of Appeals assert, it would have used language such as appears above. Inclusion of the limiting terms "continued existence" and "corporate structure" rebuts any inference that such a broad grant of power was intended.

(b) Even if it be presumed that the shareholders of a company are an aspect of its "corporate structure", the Commission may not order elimination, under Section 11(b)(2), of a class of shareholders in such a company as Fuel Oil. That action would necessarily amount to a change in the corporate structure of Fuel Oil, and the Commission may not order such change by reason of the third sentence of Section 11(b)(2).

The third sentence of Section 11(b)(2), described by the Joint House-Senate Conference Committee* as "another relaxation" of the power granted the Commission under the first sentence of Section 11(b)(2), provides:

> "Except for the purpose of fairly and equitably distributing voting power among the security holders of *such company*,
>
> [*Note:* Not among security holders of "such holding-company system", as in the first sentence of Section 11(b)(2).]
>
> nothing in this paragraph shall authorize the Commission to require any change in the *corporate structure* or *existence* of any company which is *not a holding company*. . . ."

Fuel Oil is not a holding company.** There is nothing wrong with the Fuel Oil corporate structure. Indeed, that corporate structure was created pursuant to Commission order. But the Commission now claims that the Fuel Oil corporate structure results in a system inequity. In this connection, the Commission complained to the Court of Appeals that:

> ". . . Cities and Fuel Oil focus their attention exclusively on the individual companies and ignore the consequences on the holding-company system overall" (Com. Br. 32).

But elimination of the Fuel Oil minority interests may not be justified by focusing on "the holding-company sys-

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*Analysis of Title I of Public Utility Bill, Hearings Before House Committee of Interstate Commerce on H. R. 5423, 74th Cong., 1st Sess. (1935), p. 321 at 333.

**In determining the extent of the limitation of the third sentence, attention must be paid to the distinction in the Act between a "*holding company*" referred to in the third sentence and a "*registered holding company*" referred to in the first sentence. Those terms are defined in Sections 2(a)(7) and 2(a)(12) of the Act (App. 71a).

As already noted (p. 9, *supra*), the status of Fuel Oil as a "holding company" and as a "registered holding company" was terminated in 1953, but the Commission then purported to retain jurisdiction over Fuel Oil as a "registered holding company", solely for purposes of these proceedings.

tem overall". The last sentence of Section 11(b)(2) bars change in the corporate structure of a company which is not a holding company, except change for one purpose, *viz.*, to fairly distribute voting power among security holders of *such company*—not among the security holders of the system of which such company is a part.*

Petitioner does not contend, of course, that the carefully reticulated scheme of regulation contained in the Act leaves the Commission without power to protect minority interests. Under Sections 12 and 13 of the Act, the Commission may regulate all business dealings, including contractual dealings, between or among a holding company and any of its subsidiaries.** As noted in the Commission opinion, the contract to which the Commission objects (without

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*Commission refusal to recognize the limitation imposed by the third sentence was made apparent in its brief to the Court of Appeals: "The very breadth of the statute denies the argument advanced by [Cities and Fuel Oil] that although the common stockholders . . . security interest complicates the holding company structure, Congress, nevertheless precluded the Commission from taking any remedial action" (Comm. Br. 32-33). The Commission leaves unanswered the obvious question as to why Congress enacted the third sentence which, as indicated, was explained by the Conference Committee as "another relaxation" of the Senate bill which had empowered the Commission to alter the structure of *any* company in the holding-company system.

**Section 12(f) provides in substance that it is unlawful for any registered holding company or subsidiary company thereof to negotiate, enter into, or take any step in the performance of any transaction with any company in the same holding-company system in contravention of such rules, regulations or orders as the Commission deems appropriate in the public interest, for the protection of investors or to prevent the circumvention of the provisions of the Act. Section 13(b) is almost identical with respect to contracts for service, sales and construction.

Even if it were true, as the Commission apparently contends, that the intra-system business dealings of Fuel Oil are an attempt by Cities to circumvent Section 11(b)(2), corrective action by the Commission is required by Sections 12 and 13, not by the provisions of Section 11(b)(2).

Finally, if Cities is granted an exemption under Section 3(a)(5) and it thereafter overreaches in its dealings with Fuel Oil, the Commission may, under Section 3(c), revoke the exemption and reapply to Cities and to Fuel Oil the full regulatory impact of Sections 12 and 13. See, *e.g.*, *Electric Bond & Share Company*, H. C. A. Rel. No. 11675 (1953), discussed, pp. 15-17, *infra*.

finding such contract unfair), has been in existence and known to the Commission for many years and the Commission never has so much as intimated that the contract in any way violates Sections 12 or 13, or Commission rules prescribed thereunder.

Certainly where, as here, two sections of a statute are addressed specifically to regulation of intra-system business dealings, it is a gross distortion of the statutory scheme to affect such dealings by use of a third section that relates exclusively to the "corporate structure" or "continued existence of any company in the system. Yet by invoking Section 11(b)(2), and by ignoring Sections 12 and 13 of the Act, the Commission and the Court of Appeals have in this case done exactly that.

2. The Decisions Below Reverse Commission and Court Findings and Determinations in the Prior Section 11 Reorganization of Fuel Oil.

The Commission, in approving the Plan, created the very distribution of voting power in Fuel Oil which is now held to be unfair and inequitable. In creating that pattern of distribution, the Commission specifically held that the Plan would simplify corporate structure and would remedy unfair and inequitable distribution of voting power, as required by Section 11(b)(2).* Yet, in the instant pro-

*In approving the Plan, the Commission stated:

"Arknat's Class A stock represents approximately 46% of the combined common and Class A equity of the company, and the public holdings of Class A stock alone amount to 35% of the combined equity, but, as previously noted, the Class A stock has no voting power. *This situation constitutes an unfair and inequitable distribution of voting power in direct conflict with the standards of Section 11(b)(2) of the Act. The plan will remedy this condition* because it proposes to eliminate the common and Class A stocks by exchanging them for common stocks of Fuel Oil and Arkla with full voting privileges.

"In addition, the plan will simplify the corporate structure of the system. . . . Arknat, through merger with its operating oil subsidiary, will be eliminated as a holding company." (App. 54a-55a, R. 34a.) [Emphasis added.]

ceeding, the same distribution of voting power and corporate structure which it created are held by the Commission to violate Section 11(b)(2).

Since 1952, no new factor or change of circumstance has intervened. The very same intercompany dealings that are now held to present an inherent conflict of interest, existed long prior to, and were fully disclosed in, the reorganization proceedings.

The Commission has done here exactly what this Court in *Mine Workers* v. *Eagle-Picher Co.*, 325 U. S. 335, held that an administrative body has no power to do—exercise its admittedly wide discretion a second time in disregard of its previous order to which legal sanction had been imparted by court order.

After approving the Plan, the Commission obtained a court order of enforcement* requiring distribution of nearly 2,000,000 shares of Fuel Oil stock to the more than 20,000 holders of Arknat stock, thus creating the present minority interest in Fuel Oil. If Cities is to retain its oil system intact, that vast and costly process of distribution must now be reversed and all of the stock acquired from this large group of stockholders.

Had the Commission in 1952 regarded the failure of the Plan to eliminate the public minority interest in Fuel Oil as a failure to effectuate the distribution of voting power required by Section 11(b)(2), it would have been forced to recognize that such failure left unresolved the critical issue for which the hearings had been convened.

The business relations between Fuel Oil and the Cities system were, at the time the Commission approved the plan, indentical with the dealings that are going on today. But the Commission now contends that the mere juxtaposition of those dealings with the minority interest in Fuel Oil

Arkansas Natural Gas Corp., 109 F. Supp. 522 (D. Del.); affirmed, 204 F. 2d, 797 (3d Cir.), cert. denied, 346 U. S. 865 (1953).

violates Section 11(b)(2). This is rankly arbitrary, for it was the Commission, acting with knowledge of those intra-system business dealings, which sanctioned creation of the minority interest, at great expense to both Cities and Fuel Oil.

The Commission may not now use a reservation of jurisdiction, unrelated to Section 11(b)(2), to mask complete reversal of action that it long ago approved.

3. The Decision Below Conflicts With Many Prior Precedents of the Commission.

In the last 22 years the Commission has entertained and granted scores of applications for exemptions under Section 3(a) of the Act. A large number of the applicants had subsidiaries (both utility and non-utility) with outstanding public minority interests. In not one of those cases, many of which were decided by Commissioners who actively participated in the drafting of the Act, did the Commission even suggest that the presence of such minority interests was in conflict with Section 11(b)(2) or any other section of the Act.*

*In only a few of those decisions did the Commission comment upon the existence of a public minority interest in a subsidiary of the applicant. It is necessary, therefore, to go to the record in every other proceeding, or to some published source, such as *Moody's Manuals*, to determine the consistency with which the Commission heretofore has declined to regard a publicly held minority as being a material factor in an exemption proceeding.

Connecticut Power Co., 1 S. E. C. 200 (1936); Moody's Util., 1937, p. 1271; *Standard Oil of Indiana*, 11 C. A. Rel. No. 165 (1936); *Standard Oil and Gas Co.*, 1 S. E. C. 404 (1936); Moody's Ind., 1937, p. 2435; *Union Pacific R.R.*, 1 S. E. C. 441 (1936); Moody's Railroads, 1937, p. 843; *Northern States Power Co.*, 1 S. E. C. 524 (1936); Moody's Util., 1937, p. 452; *Monarch Mills*, 1 S. E. C. 822 (1936); Moody's Ind., 1937, p. 2366; *American Allied Products Co.*, 1 S. E. C. 870 (1936); *Consolidated Oil Corp.* [Now Sinclair Oil Corp.], 2 S. E. C. 165 (1937); Moody's Ind., 1838, p. 767; *Youngstown Sheet and Tube Co.*, 2 S. E. C. 873 (1937); Moody's Ind., 1937, p. 1709; *Kennecott Copper Corp.*, 3 S. E. C. 241 (1938); Moody's Ind., 1939, p. 2976; *Hudson Oil*

For example, the decision below is directly contrary to the result reached by the Commission in *Electric Bond & Share Company*, P. U. C. A. Rel. No. 11675 (1953). That case involved, among other things, an application by Bond & Share for exemption under Section 3(a)(5) of the Act. In the course of the proceedings, the Commission inquired into the relationships of Bond & Share to its subsidiary public utility holding company, American & Foreign Power. The latter company shortly before was reorganized under Section 11(e) of the Act and, as was the case in the reorganization of Fuel Oil, a large public minority interest emerged as a result of the plan, the majority of the stock of the reorganized company being held by Bond & Share. In later proceedings for exemption the existence of the large public minority interest was held to be no bar to exemption for the parent company. The Commission said:

> "The plan of Foreign Power which we have approved seeks by charter provisions to protect the public minority interest by requiring a certain percentage of the public stockholders' votes in order to take affirmative action with respect to certain vital corporate matters. These charter provisions are designed to prevent exploitation by the majority stockholders and disenfranchisement of the minority.

Corporation, 3 S. E. C. 457 (1938); Moody's Ind., 1939, p. 334; *Standard Oil Company of California*, 4 S. E. C. 826 (1939); Moody's Ind., 1940, p. 2751; *Pacific Gas & Electric Co.*, 10 S. E. C. 39 (1941); Moody's Util., 1942, p. 801; *International Utilities Corp.*, 21 S. E. C. 283 (1945); *Mead Corp.*, 11 C. A. Rel. No. 6367 (1964); Moody's Ind., 1937, p. 2857; *Texas Utilities Co.*, 31 S. E. C. 376 (1950); Moody's Util., 1951, p. 1280; *Northern States Power Co.*, 11 C. A. Rel. No. 12055 (1954); *Baltimore Gas & Electric Co.*, 11 C. A. Rel. No. 13080 (1956); *Ford Motor Co.*, 11 C. A. Rel. Nos. 13301 and 13314 (1956), and see *Eastern Gas & Fuel Associates*, 30 S. E. C. 834 (1950), where the Commission approved a plan submitted to comply with Section 11(b)(2), which plan made *no change* in minority interests in certain non-utility subsidiaries. After consummation of the plan the Commission granted Eastern's application for exemption without mention of the minority interests (11 C. A. Rel. No. 12807 (1955)). See also *Standard Oil Company (New Jersey)*, 15 S. E. C. 373 (1944).

[*N. B.*: The Commission was here changing the "corporate structure" of Foreign Power in order to ensure a fair distribution of voting power within that company.]

". . .

"Under these circumstances, we are of the view that the continuation by Bond and Share over Foreign Power is not prejudicial or detrimental to the interests of investors of Foreign Power or of Bond and Share, and, therefore, believe that Bond and Share could enjoy the same status with respect to an exemption from the Act under Section 3(a)(5) as would Foreign Power." [H. C. A. Rel. No. 11675, at p. 19]

In that case, the Commission saw no bar to exemption even though (a) there existed a 45% minority interest in a subsidiary of a registered holding company; (b) the minority interest existed in a company which was itself a registered holding company; (c) the registered holding company subsidiary held minority interests in other public utility subsidiaries; and (d) the minority stockholders in the registered holding company subsidiary were deprived, over their objection, of cumulative voting (a right granted and exercised fully by the Fuel Oil minority).*

Another case remarkably similar on its facts, but not its result, to the instant case is *Standard Oil Company (New Jersey)*, 15 S. E. C. 373 (1944). There the Commission terminated the status of Standard Oil (New Jersey) as a "registered holding company" as soon as Standard had disposed (as has Cities) of its utility interests. The Commission order contained no conditions respecting minority interests in subsidiaries, notwithstanding that there were substantial public minority interests outstanding in several large oil company subsidiaries, the principal two being

*For enforcement proceedings of the American & Foreign Power Co. plan, see *In re American & Foreign Power Co.*, 80 F. Supp. 514, 534 (D. Maine 1948); 102 F. Supp. 331, 336 (D. Maine 1951).

Humble Oil & Refining Company and Creole Petroleum Corporation. Moreover, at the time exemption was granted Standard, an action was pending in the New York Supreme Court in which a minority stockholder of Creole charged that Standard had dominated and controlled Creole to its detriment and financial loss. See *Price* v. *Standard Oil Co.*, 55 N. Y. S. 2d 890 (1945).

The impact of the long line of Commission precedents contrary to the instant case cannot be avoided, as the Commission sought to do in its Opinion (App. 32-33a; R. 12a-14a) by reference to a few Commission decisions approving *voluntary* plans submitted under Section 11(e), decisions dealing with the elimination of minority interests in subsidiary public utility companies with "integrated public utility systems." (See Section 11(b) (1)). Never in its long administration of the Act, has the Commission forced the elimination of a publicly-held minority interest against the desires of management.*

B. The decisions below [1] will affect substantially all registered public utility holding companies, [2] are contrary to decisions of this Court, and [3] conflict with principles, long established by the Congress, governing intercorporate transactions.

The vice of the decisions below rests in the premise that business dealing, however fair, between a corporation and

*The lack of precedent for Commission action was candidly conceded in the brief which the Commission Staff filed in the proceedings before the Commission:

> "[I]n no case, absent a commitment to effect such an elimination, has the Commission ever entered an order under Section 11(b) mandatorily requiring it [the elimination of a minority interest] against the desires of management where the existence of the minority interest and the related business relationship problems have been the sole basis for action under Section 11(b)." (Reply Brief of Division of Corporate Regulation of the Securities and Exchange Commission, dated December 1, 1955; Dock. No. 31, p. 9).

the owner of a majority of its stock raises an "inherent conflict of interest", leaving the minority "effectively disenfranchised".

1. Public Utility Holding Companies Affected by the Decisions.

The decisions below have direct effect upon 14 of the 25 presently registered public utility holding companies.* Moreover, if its duty is to eliminate minority interests under the rule enunciated in this case, the Commission must now revoke, under Section 3(c) of the Act, exemptions heretofore granted the many companies listed in the footnote at page 15, *supra*. The Commission will have to order those companies, as it has ordered Cities, to eliminate the minority interests which exist in their subsidiaries—to do otherwise would arbitrarily discriminate against Cities. The supposed danger to the minority interest in Fuel Oil is certainly no greater than that existing in any of those other companies.

2. The Decisions Below Conflict with Decisions of this Court.

This Court, in *Comstock v. Group of Investors*, 335 U. S. 211, a proceeding under Section 77 of the Bankruptcy Act, held that domination of a subsidiary by its parent is

> "... a relationship between corporations which the law has not seen fit to proscribe." (335 U. S. at 229)

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*Of the 25 presently registered holding companies, 10 have subsidiaries with outstanding minority interests in the common stock of such subsidiaries. If preferred stock is considered a part of the ownership of subsidiary corporations (which the Commission has held it to be), four more of the registered holding companies must be included as directly affected by this decision.

There, a parent company had exercised control over a subsidiary through majority stock ownership. This Court held that

> ". . . mere existence of an opportunity to do wrong"

through majority control of a subsidiary is not inequitable, rather

> ". . . it is the unconscionable use of the opportunity afforded by the domination to advantage itself at the injury of the subsidiary"

that makes such domination unfair.

In the *Comstock* case, as here, the relationships between the parent and the subsidiary were

> ". . . the outgrowth of complicated, but legitimate good faith business transactions, neither in design or effect producing injury [to the minority]." (335 U. S. at 229).

The *Comstock* case has direct application to proceedings under Section 11 of the Act.* This was recognized in *In re American & Foreign Power Co.*, 80 F. Supp. 514 (D. Maine, 1948) where the court observed:

> "In the present case there was, undoubtedly, control of the subsidiary by the parent. As Mr. Justice Jackson has said in Comstock v. Group of Investors, 335 U. S. 211, this is 'a relationship which the law has not seen fit to proscribe.'" (80 F. Supp. at 530).

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*Compare Section 11(e) of the Act (a plan must be "fair and equitable to the persons affected by such plan") with Sections 77(c) and (e) of the Bankruptcy Act, 11 U. S. C. § 205 (the Interstate Commerce Commission and the District Court must find that a plan of reorganization is "fair and equitable, affords due recognition to the rights of each class of . . . stockholders, [and] does not discriminate unfairly in favor of any class of . . . stockholders.") and Chapter X of the Bankruptcy Act, 11 U. S. C. § 621 (a plan must be "fair and equitable, and feasible").

As already noted (pp. 16-17, *supra*) the facts in the *Electric Bond & Share Company* case and in the instant case are so remarkably similar as to require like disposition of the cases.

In *Schwabacher* v. *United States*, 334 U. S. 182, this Court reviewed an order of the Interstate Commerce Commission, approving the merger of the Chesapeake & Ohio Railway Company and Pere Marquette Railway Company, subsidiaries of Alleghany Corporation. The ICC order, while approving perpetuation of a minority interest in the merged company, had left dissatisfied minority stockholders the right to eliminate themselves by appraisal proceedings. This Court held that even voluntary elimination for minority stockholders should not have been permitted by the ICC.

3. The Decision Below Conflicts with Principles, Long Recognized by Congress, Governing Intercorporate Transactions.

Although the decision below is directed against a registered public-utility holding company, the rationale of the decision has a far broader impact.

Section 5(2) of the Interstate Commerce Act (49 U. S. C. § 5(2)) was passed to regulate holding companies in the transportation field.* In administering that Act, the ICC has many times approved acquisitions, over objection by resulting minorities, of controlling stock interests in railroad corporations. See, *e.g.*, *Schwabacher* v. *United States*, 334 U. S. 182; *Benton* v. *United States*, 114 F. Supp. 37 (M. D. Ga. 1953). In the latter case, where minority stockholders sought to enjoin an acquisition of control that had been authorized by the ICC, the court pointed out that:

*See *Alleghany Corp.* v. *Breswick & Co.*, 353 U. S. 151; S. Rep. No. 87, 73d Cong., 1st Sess. p. 1.

> "... It must be kept in mind that when a person becomes a stockholder in a corporation, he assents to majority rule and impliedly agrees to abide thereby". (114 F. Supp. at 45)

The Interstate Commerce Act and the Public Utility Holding Company Act regulate holding companies, one in the transportation field, the other in the public utilities field. Common principles govern administration of those acts. The decision below is in conflict with such of those common principles as relate to the propriety of public minority interests in subsidiaries. That conflict requires examination by this Court.

CONCLUSION

The decision below raises questions of basic importance in administration of the Public Utility Holding Company Act of 1935. It is respectfully submitted that the petition for certiorari should be granted.

Respectfully submitted,

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